Dissenting Views on H.R. 3269, "Corporate and Financial Institution Compensation Fairness Act of 2009"

Lavish executive compensation packages for CEOs who have underperformed and failed to deliver shareholder value have contributed to a growing public perception that corporate boards have not fulfilled their fiduciary responsibility to set executives' pay in a way that aligns the incentives of those executives with the interests of shareholders. This perception undermines confidence in corporate America, and unfairly taints the vast majority of U.S. companies that adhere to sound corporate governance practices in determining the compensation of CEOs and other senior management. The huge losses suffered by large financial institutions in recent years and the need for the government to inject billions of taxpayer dollars into several before on the issue of excessive executive compensation.

H.R. 3269 purports to address these excesses by mandating that all publicly-traded companies registered with the U.S. Securities and Exchange Commission (SEC) provide shareholders the opportunity to cast a non-binding advisory vote on executive compensation as disclosed in the corporate proxy statement. It would also require proxy statements related to a corporate merger or acquisition to include a clear and simple disclosure of any new `golden parachute' plans, or severance pay arrangements whereby top executives receive extra compensation when the corporation is merged with or acquired by another firm. The legislation further mandates a separate, non-binding shareholder vote on these `golden parachute' compensation arrangements. The legislation directs all public companies to have compensation committees comprised of independent directors and requires the SEC to issue independence standards for compensation consultants to the board of directors. Finally, as detailed further below, the legislation grants the Federal financial regulators broad powers to prohibit incentive-based compensation for all employees of financial institutions over a certain size in the United States.

While Republicans share the outrage of our constituents over instances in which corporate CEOs have been richly rewarded for failure, we strongly believe that H.R. 3269 is the wrong solution. By empowering government bureaucrats to sit in judgment of the `incentive-based' compensation of every employee at thousands of financial institutions across the country, the bill represents another example of a `command and control' approach to economic policy that runs counter to America's free market traditions.

Section 4 of the legislation would require the overwhelming majority of U.S. financial institutions (including but not limited to banks, credit unions, broker-dealers, and investment advisors) to disclose incentive-based compensation arrangements, and authorize Federal regulators to control and dictate all incentive-based compensation agreements for all employees of those firms, in order to prevent compensation arrangements that encourage `inappropriate risks' that `threaten the safety and soundness' of individual financial institutions or `have serious adverse effects on economic conditions or financial stability.' The bill would grant broad, vague and undefined powers to Federal regulators to determine if incentive-based compensation structures at financial institutions are `aligned with sound risk management,' `structured to account for the time horizon of risks,' and `meet other criteria [the regulators] determine to be appropriate to reduce unreasonable incentives to take undue risks.'

As introduced, H.R. 3269 would have subjected every financial institution--regardless of size, regardless of whether it is publicly traded, and regardless of whether it played any role in the financial turmoil of the recent past--to this unprecedented level of government micro-management of basic business practices. Only through the efforts of Financial Services Committee Republicans was language authored by Mr. Hensarling added to the bill during Committee consideration to exempt financial institutions with less than $1 billion in assets from these requirements.

In evaluating the bill's provisions to give shareholders an advisory vote on executive compensation, it is important to keep in mind that corporations are representative--not direct--democracies, and mandating shareholder votes on core operational issues such as compensation levels risks undermining corporate boards' ability to exercise independent judgment on behalf of all of the corporation's shareholders. Evidence suggests that if shareholders are granted a non-binding compensation vote, some will use the new power to push their own political and social agendas that may well conflict with the interests of the majority of shareholders. Because this bill explicitly states that no shareholder proxy rights are prejudiced by the non-binding executive compensation vote, it could also spur frivolous litigation if corporate boards reject or refuse to abide by the results of the shareholder vote.

Republican Members of the Committee voted almost unanimously for a commonsense alternative, offered by Mr. Garrett, which no Democratic Member of the Committee supported. Republicans hope to offer a similar version during consideration in the House. The Garrett substitute replaced the annual `say-on-pay' provision with a triennial, nonbinding shareholder vote on executive compensation, which is a forward-looking vote that strengthens shareholder rights. Annual votes on executive pay packages are inappropriate because most executive compensation agreements are for terms of more than one year. Moreover, requiring annual `say on pay' votes makes it impossible for public and private pension and retirement funds--which hold the stock of thousands of companies in their portfolios--to adequately fulfill their fiduciary duties to their investors by performing comprehensive evaluations of all the compensation packages for all the companies in which they hold equity securities. In a July 20, 2009 letter to the SEC, the pension fund for the United Brotherhood of Carpenters and Joiners union warned that proposals to mandate annual `say on pay' votes for all public companies would be `irresponsible, undermining executive compensation reform efforts and the voting responsibilities of institutional investors.' Finally, the Republican alternative struck the provisions of Section 4 (described above) establishing a new government role in regulating compensation, both executive and non-executive, at every financial institution in America with more than $1 billion in assets.

The Committee on Financial Services ordered H.R. 3269 favorably reported without holding a single legislative hearing to examine its far-reaching effects on corporate governance and employee compensation practices, despite two written requests from Committee Republicans demanding such a hearing. Republicans believe that the House should reject this ill-considered legislation and send it back to the Committee on Financial Services for a more thorough review of its potential unintended consequences.

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